

## Poverty-reducing power of growth is low in sub-Saharan Africa



Adapted from World Bank (2014a).

# 3 Drivers of Inequality in the Context of the Growth-Poverty-Inequality Nexus in Africa: An overview of key issues

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## 3.1 Introduction

Approximately one-third of the world's poor live in Africa. More recently, evidence shows that inequality may indeed be a more significant challenge in Africa than in other regions of the developing world. High levels of poverty and inequality persist in Africa despite its being one of the fastest growing regions in the last decade. In particular, six of the world's ten fastest growing economies during 2001-2010 were in sub-Saharan Africa (SSA) (The Economist and IMF, 2011). Specifically, the fastest growing economies in Africa in this decade (2001-2010) were Angola, followed by Nigeria, Ethiopia, Chad, Mozambique, Rwanda and Equatorial Guinea.

For Africa, the period from the 1970s to the late-1990s can in general be considered lost decades since independence. This period has been characterised by: a combination of serious governance failures; low and sub-optimal investment in health, education and other social services; significant macroeconomic imbalances; poor infrastructure; and structural trade deficits. The post-2000 African economic boom, in contrast, has been built on a composite of factors, including: technology (mobile in particular); demographic growth, urbanisation and the rise of new, dynamic African cities; improved macro-economic policy; enhanced regional cooperation and integration; better targeted social policy; and significant increases in the quality of governance and institutions. In turn, these factors have enabled the growth momentum on the continent to be maintained. Africa's socioeconomic variables have not, however, matched this impressive economic performance; poverty and higher levels of inequality remain features of many African economies. Within this context, this chapter looks more closely at the evolution of inequality on the continent over time as well as some of its key drivers.

There are three stylized facts about the growth-poverty-inequality linkages that have emerged out of studies on developing economies, summarised well by Ferreira and Ravallion (2008). First, growth rates among developing countries are virtually uncorrelated with changes in inequality. Second, in the absence of the above relationship, there must be a strong relationship between growth and changes in poverty. Empirical evidence has strongly shown that faster growing economies reduce poverty more rapidly. Finally, high initial inequality reduces the poverty-reducing power of growth, and more so if inequality rises through the growth process.

This chapter will build on these stylized facts to shed light on the nature and size of, the changes in, and the drivers of, inequality in the African context.

This chapter examines the following: Section 3.2 explores growth-poverty-inequality interactions in the African context and focuses on describing the shape and size of inequality in Africa; Section 3.3 looks at structural transformation in economic growth patterns; Section 3.4 investigates in more detail the potential drivers of inequality in Africa in terms of microeconomic and institutional considerations; and Section 3.5 concludes.

## 3.2 Growth, poverty and inequality: the African context

The Africa-specific literature on growth-poverty-inequality linkages is sparse. Fosu (2009) finds that, consistent with previous work, initial inequality differences can lead to substantial differences in growth-poverty elasticity, not only between SSA and other regions, but also between countries within SSA, therefore emphasising the path-dependent nature of the phenomenon. Recent work by Fosu (2014), which decomposes poverty changes during the early 1990s and the late 2000s for 23 African countries, shows that economic growth explains the majority of the changes in poverty for the group of countries experiencing poverty reduction. However, where poverty increased, inequality was more important in explaining the change. Importantly, even among those countries that experience declining poverty, for a few of them, declining inequality was the dominant factor. This heterogeneity points to the importance of country-specific studies. Each country's growth-poverty-inequality relationship is no doubt influenced by issues relating to natural resource dependence, conflict and fragility, and governance issues. However, currently, there is little systematic evidence of the evolution of growth-poverty or growth-inequality elasticities within African economies that is influenced disproportionately by any one or combination of these factors.

In the last two decades, high poverty levels in Africa and associated development issues have taken centre stage in the African development literature. Much has been documented about changes in poverty levels, growth-poverty elasticities and macroeconomic drivers of poverty. Over this time, the issue of inequality has arguably been relatively neglected, possibly in part due to the lack of credible time-series data on changes in income distribution in African economies.<sup>1</sup>

### 3.2.1 *The nature, size and pattern of inequality in Africa*

More recently, it has increasingly been acknowledged that some of the most unequal economies in the world are in Africa. Using the Gini coefficient as the measure of within-country income inequality, table 3.1 shows that the average Gini coefficient in Africa is 0.43, compared to the rest of the developing world, at 0.39. Furthermore, the upper bound of the continent's range of Gini coefficients exceeds that of the developing world, indicating that extreme inequality is also a distinct feature on the African continent. Using another measure of income inequality, on average, the top 20.0 per cent of income earners in Africa have an income that is over 10 times that of the bottom 20.0 per cent. For other developing economies, this average is below 9.

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<sup>1</sup> The lack of strong statistical systems in most African countries prevents adequate tracking of poverty and inequality trends at national and sub-national levels, which also hampers the ability to clearly identify the determining elements behind these trends.

**TABLE 3.1** Inequality in Africa versus other developing economies

	Africa	Other developing countries	Difference
<b>Gini</b>			
Average	0.43 (8.52)	0.39 (8.54)	0.04**
Median	0.41	0.38	
Minimum	0.31 (Egypt)	0.25 (Ukraine)	
Maximum	0.65 (South Africa)	0.52 <sup>a</sup> (Haiti)	
<b>Ratio of incomes:</b>			
Top 20% / bottom 20%	10.18	8.91	
<b>Average Gini coefficient</b>			
Low-income	0.42 (7.66)	0.39 (11.84)	0.03
Lower-middle-income	0.44 (8.31)	0.40 (8.55)	0.05*
Upper-middle income	0.46 (11.2)	0.40 (8.29)	0.06*

**Source:** UNU-WIDER (2014); World Bank (2014b), World Development Indicators 2014.

**Notes:**

1. Other developing economies have been chosen according to the World Bank classification of a developing economy, which includes a range of countries from Latin America, Asia and Eastern Europe.
  2. The latest available data were used for each country (after 2000).
  3. Standard deviations are shown in parentheses.
  4. The small sample size of other developing countries in the low-income group makes it difficult to determine statistical significance.
- <sup>a</sup> The highest Gini coefficient in the 'other developing countries' category, at 0.61, is found in the small island nation of the Federated States of Micronesia, and has been excluded here for comparability.
- \*\* Significant at the 5% level. These results are from simple t-tests.
- \* Significant at the 10% level. These results are from simple t-tests.

The distribution of Gini coefficients as illustrated in figure 3.1 shows that the African distribution lies to the right of that of the rest of the developing world,<sup>2</sup> which confirms the earlier observation of Africa's high levels of inequality. In fact, 60.0 per cent (30 out of 50) of the African countries in this sample fall above the median Gini coefficient for all developing economies.

An outstanding feature of this graph is the prevalence of extreme inequality in Africa, which is not observed in other developing economies. There are 15 African countries in the fourth quartile of the entire distribution of Gini coefficients for all developing economies. Furthermore, there are seven outlier African economies that have a Gini coefficient of above 0.55: Angola, Central African Republic, Botswana, Zambia, Namibia, Comoros and South Africa.<sup>3</sup> Most of these are Southern African middle-income countries, which all exhibit considerably high levels of inequality, with Gini coefficients within the 0.57–0.64 range.

Notably, however, some of the fast-growing, populous countries on the continent, such as Nigeria, United Republic of Tanzania and the Democratic Republic of the Congo, have significantly lower

<sup>2</sup> Kolmogorov-Smirnov tests for equality of distributions are rejected at the 5.0 per cent level, suggesting that distribution of inequality in Africa is distinct from that for the rest of the developing world.

<sup>3</sup> This is based on income measurement – as opposed to the consumption approach as in other parts of this book.

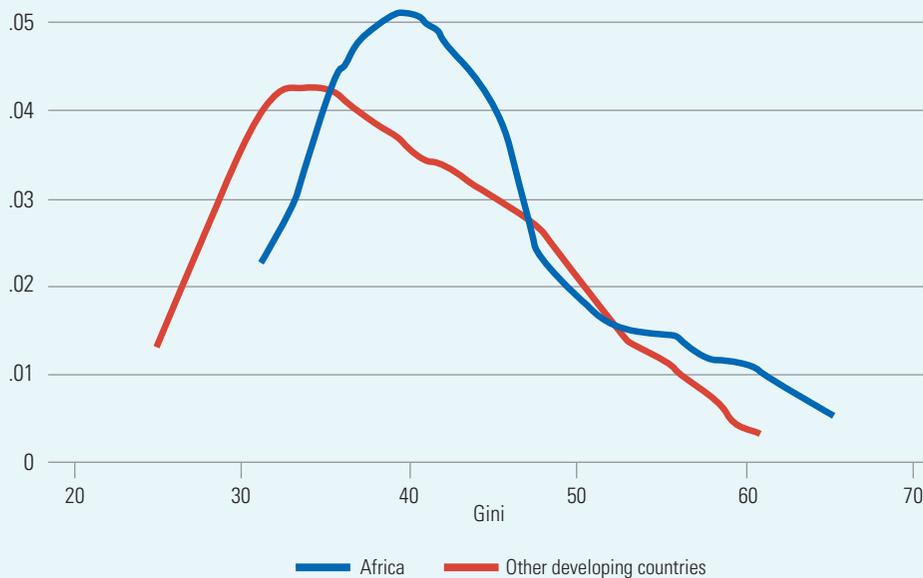
Gini coefficients of between 0.34 and 0.44. Using population data from the World Development Indicators (WDI, 2014), the population-weighted Gini for Africa was calculated as 0.41; around 10.0 per cent of the African population lives in the seven most unequal economies.

Given the poor quality of historical economic data, it is difficult to assess changes in inequality in Africa over time. However, the United Nations University World Institute for Development Economics Research (UNU-WIDER) has compiled the best available Gini coefficients over time in the World Income Inequality Database (WIID), which is used in figure 3.2. The estimates show that for Africa, on average, there has been a slight reduction in the Gini coefficient from 0.48 during the early 1990s to the current level of 0.43 – a 10.4 per cent decline.

When excluding the seven outlier African economies, it can be observed that the average Gini coefficient for the rest of the continent declined from 0.45 in the early 1990s to a current level of 0.40. This latter average, when compared with the data in table 3.1, is almost equal to that of the rest of the developing world. In essence, the data here would suggest that it is the seven extremely unequal African countries, then, that are driving the results that place African inequality levels above that of other developing economies.

Figure 3.3, in turn, emphasises that, after 1999, the overall decline in inequality in Africa has been driven disproportionately by the decline in inequality of the ‘low inequality’ sub-sample of African

**FIGURE 3.1** Distribution of Gini coefficients: Africa and other developing economies



**Source:** UNU-WIDER (2014); World Bank World Development Indicators (2014b); own graph.

**Notes:**

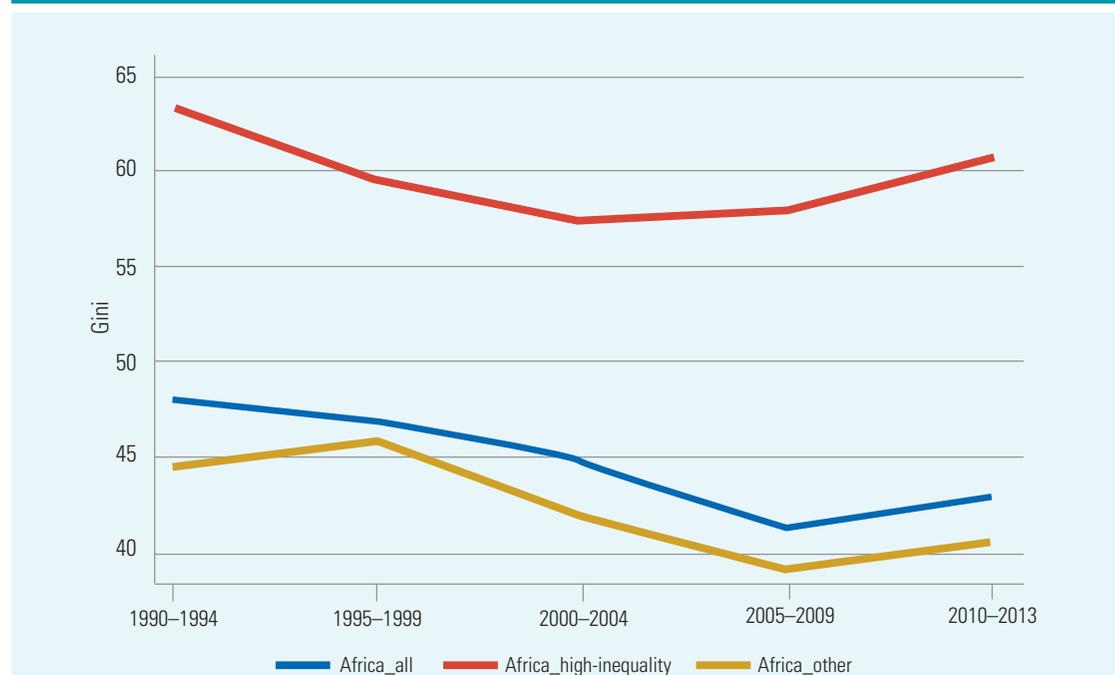
1. The latest available data were used for each country (after 2000).
2. Kolmogorov-Smirnov tests for equality of distributions are rejected at the 5% level.
3. The vertical axis represents density.

economies. The cohort of ‘high inequality’ African economies has jointly served to restrict the aggregate decline in African inequality.

The averages illustrated in figure 3.3, however, hide much of the variation observed across different countries. There are several studies that confirm the heterogeneous experiences of African countries regarding the growth-inequality-poverty relationship (Bigsten and Shimeles, 2004; Demombynes and Hoogeveen, 2004; Canagarajah and Thomas, 2001; Appleton, 1999; Ssewanyana et al., 2004; McCulloch, Baulch and Chereh-Robson, 2000). In light of this mixed experience across different countries, there is a need to more deeply examine sources of growth and initial levels of inequality to explain the observed trends.

Using the WIID Gini coefficients and the World Bank (2014b) for growth data, this analysis shows a weak relationship between rate of economic growth and change in the Gini coefficient for a large sample of African economies. However, the relationship is visibly stronger for the subset of economies that have an initially high Gini coefficient.<sup>3</sup> In addition, the correlation between initial inequality and

**FIGURE 3.2** Movements in the Gini coefficient, 1990-2013



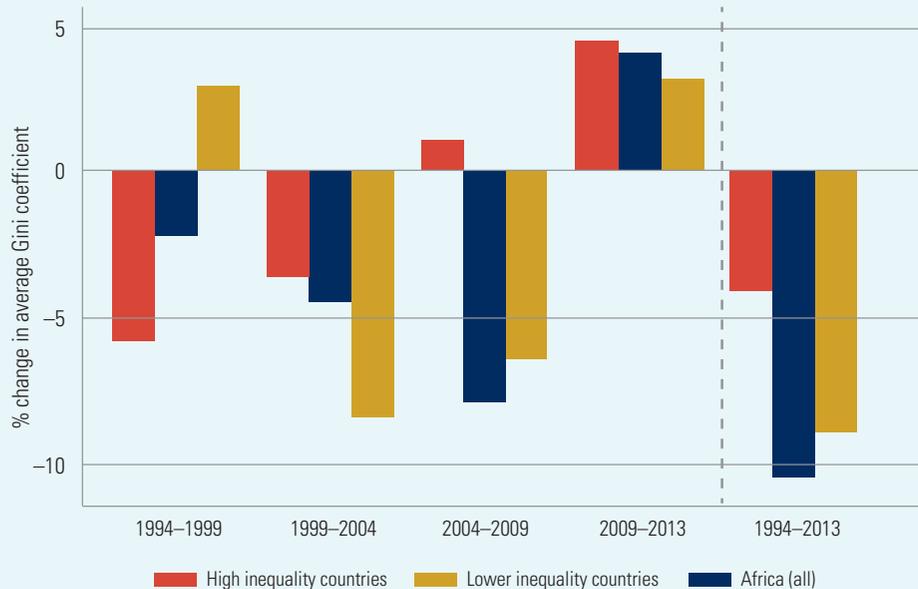
**Source:** UNU-WIDER (2014); World Bank (2014b), World Development Indicators 2014; own graph.

**Notes:**

1. For the Africa average, the sample sizes per period are as follows: 27 countries (1990-1994), 24 countries (1995-1999), 38 countries (2000-2004), 28 countries (2005-2009) and 25 countries (2010-2013).
2. The high inequality countries are: Angola, Botswana, Central African Republic, Comoros, Namibia, Lesotho, South Africa and Zambia. The sample sizes per period are as follows: five (1990-1994), two (1995-1999), seven (2000-2004), three (2005-2009) and three (2010-2013).

<sup>3</sup> A Gini coefficient above 0.5 in the 1990s.

**FIGURE 3.3** Rates of change in income inequality in Africa



**Source:** UNU-WIDER (2014); World Bank (2014b); own graph.

**Notes:**

1. For the Africa average, the sample sizes per period are as follows: 27 countries (1990-1994), 24 countries (1995-1999), 38 countries (2000-2004), 28 countries (2005-2009) and 25 countries (2010-2013).
2. The high inequality countries are Angola, Botswana, Comoros, Central African Republic, Namibia, South Africa and Zambia. The sample sizes per period are as follows: five (1990-1994), two (1995-1999), seven (2000-2004), three (2005-2009) and three (2010-2013).

current inequality for the above sample of African countries is statistically significant, at the 1.0 per cent level, with a magnitude of 0.56. These results only show that initial inequality can potentially explain a large proportion of current levels of inequality, emphasising the path-dependent nature of the phenomenon. It would also follow, then, that not only do the sources of growth matter for inequality, but so do initial conditions.

The synthesis of the authors' own observations and the findings in the literature point to a set of early conclusions. First, it is difficult to derive a clear and consistent storyline around the nature and pattern of inequality across Africa given the substantial variation in both levels and changes over time. Second, it can be suggested that although data provisionally point to the fact that inequality has on average declined in Africa, it is driven mostly by the economies not classified as highly unequal. Third, Africa has a higher mean and median level of inequality than the rest of the developing region. Fourth, an important feature of inequality on the continent is the presence of the 'African outliers': seven economies exhibiting extremely high levels of inequality. When excluding these African outliers, it is evident that Africa's level of inequality approximates those of other developing economies. Finally, estimating the relationship between growth and inequality suggests that for countries with initially high inequality, there is a stronger relationship between economic growth and inequality.

### 3.2.2 Africa's growth-poverty-inequality nexus

Despite the remarkable macroeconomic performance of Africa over the last decade, the continent has fallen behind in its goal of poverty reduction. While extreme poverty has fallen since 1990, almost 50.0 per cent of Africa's population (413 million people) continue to live below the extreme poverty line (World Bank, 2014b). Poverty is now falling in Africa, but not as rapidly as in South and East Asia. This has resulted in Africa's share of global poverty increasing from 22.0 per cent in 1990 to 33.0 per cent in 2010 (Africa Progress Panel, 2014).

Using 2014 World Bank data (PovcalNet), it can be observed that across most of Africa, except North Africa, the proportion of the population living below the extreme poverty line is similar on average, at 39.0–46.0 per cent of the population. This is significantly higher than the poverty rates in the other developing regions of South Asia and Latin America and the Caribbean (LAC). For example, the proportion of people living in extreme poverty in Central Africa is 2.5 times that of South Asia and 4.6 times that of LAC. Clearly, there are marked variations in poverty levels across the different countries. Four of the most populous countries in Africa – Nigeria, Ethiopia, Democratic Republic of the Congo and United Republic of Tanzania – are home to almost half of Africa's poor, which inextricably links Africa's progress in reducing poverty to the performance of these countries.

Furthermore, the depth of poverty in Africa is more extreme. For those living below the poverty line in Africa, the average consumption level is only US\$0.70 a day, considerably below the level in other regions, which are all nearly approaching the \$1-a-day level (Africa Progress Panel, 2014). This can also be seen in figure 3.4, where around two-thirds of the population in the four African regions, excluding North Africa, that are living below the \$2-a-day poverty line are living in extreme poverty; around one-third live on \$0.25 to \$2 a day. In contrast, in South Asia, 60.0 per cent of the poor live on average incomes of \$1.25 to \$2 a day.

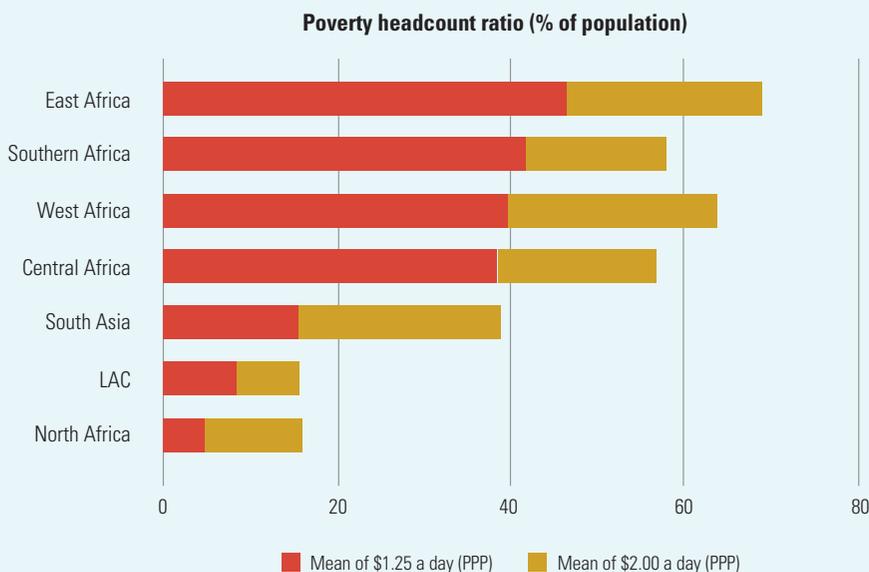
Clearly, there are obstacles to Africa's poverty-reducing power of growth. Indeed, estimated growth elasticity of poverty in the two decades since 1990 in SSA is -0.7, which implies that a 1.0 per cent growth in GDP is estimated to reduce poverty by 0.7 per cent (World Bank, 2013). For the rest of the world (excluding China), however, this elasticity is substantially higher, at -2.

An important factor mediating the growth-poverty relationship is, as expected, inequality. Higher initial inequality has been shown to hamper the poverty-reducing effects of growth (Ravallion, 1994; Fosu, 2009). In particular, Fosu's (2009) calculations of income-growth elasticities for 30 countries in SSA over the 1977–2004 period reveal substantial variation in the estimates, from 0.63 in Namibia, a highly unequal country, to 1.4 in Ethiopia.

In addition, as noted above, it is not only growth that matters, but also where the sources of growth are located. Evidence has shown that growth in labour-intensive sectors such as agriculture or manufacturing are typically more poverty-reducing than growth in capital-intensive sectors such as mining (Ravallion and Datt, 1996; Khan, 1999; Ravallion and Chen, 2007; Loayza and Raddatz, 2010). The growth path of many African economies where resource-extractive industries are dominant would thus be an important determinant of the observed low growth-poverty elasticities for the region.

Supporting the importance of these factors, it can be observed that when they are controlled for through a variety of variables, growth elasticity of poverty in SSA approaches that of the rest of the

**FIGURE 3.4** Poverty rates across Africa, LAC and South Asia, 2010



**Source:** World Bank (2014c) PovcalNet 2014.

**Notes:**

1. Authors' calculation of average poverty rates per region using the United Nations regional classifications.
2. PPP = Purchasing power parity; LAC = Latin America and the Caribbean.

world (World Bank, 2013). The impact of growth on poverty reduction is lower when initial inequality and mineral resource dependence are higher (*ibid.*). Thus, high and rising levels of inequality are an important hindrance to poverty alleviation on the continent, arguably the biggest development challenge of the century. The following sections uncover some of the important drivers of inequality in Africa.

### 3.3 Macroeconomic drivers of inequality: structural transformation and growth

Despite the recent growth rates recorded in Africa, there is a genuine concern regarding the long-term sustainability of Africa's rapid economic expansion and importantly, whether this high growth at the country level can be translated into achieving key development objectives, such as poverty reduction, more equitable distribution of income, enhanced human capital accumulation, and improved infrastructure. The drivers of economic growth are then critical to understanding whether growth is likely to be sustainable, and more importantly, more inclusive. Economic theory and cross-country experience have indicated that a more diverse economic base increases the probability of sustained economic performance at the country level. This is also true because it more likely that gains deriving from growth driven by a more diverse range of economic sectors will be more equitably

distributed. As discussed below, a more equitable income distribution results in a middle-class that is able to act as the driver of domestic consumption.

Structural transformation is the reallocation of labour from low- to high-productivity sectors, and when this change is rapid, it can boost growth significantly. In Rodrik's (2014) typology of growth processes, it can be observed that rapid Industrialisation or structural change to high-productivity sectors can quickly shift countries into middle- or upper-income status. This highlights his evidence that modern manufacturing industries exhibit unconditional convergence to the global productivity frontier (ibid.). This is the classic pattern of growth in low-income countries where surplus labour moves from agricultural activities to industrial jobs, spurred by an export-led economic diversification strategy. In the later stages of this development process, however, growth begins to disproportionately rely on fundamental capabilities such as the availability and quality of institutions and human capital. For countries further along in the development process (i.e., middle-income countries), growth tends to be more capital- and skills-intensive, and more reliant on the services sector. In these countries, domestic demand is a key element of sustaining economic growth, and therefore, the impact that growth has on the distribution of income, insofar as it affects the size of the middle class, is an important growth challenge (Kharas and Kohli, 2011). In Section 3.2, it was evident that several middle-income Southern African economies exhibit high levels of income inequality, which points to a small middle-class, and that these economies have been growing at rates below comparator countries. It is in these contexts that the complexity of the growth-inequality-poverty nexus is fully revealed.

In Africa, the agricultural sector remains an important contributor to GDP, particularly in West, East and Central Africa, where it contributes 29.0 per cent, 36.0 per cent and 40.0 per cent of GDP, respectively (table 3.2). Over time, however, there has been a gradual shift away from the traditional agricultural sector, but not towards manufacturing as in the classic pattern of economic development, as experienced by the European industrializers and more recently, East Asia. Where industry<sup>4</sup> has grown in Africa, it is dominated by mining activities, which indicates there has been a considerable decline in manufacturing value added since the 1990s and 2000s across the continent. In contrast, the tertiary services sector has absorbed most of the shift away from agriculture, becoming the largest share in GDP for most parts of the continent.

A closer examination of the dynamics of the secondary sector across African economies shows that, at an individual country level, only 15 of the 50 African countries included in this sample have increased the share of manufacturing in GDP since 2000, with many of the changes of a small magnitude (figure 3.5). Figure 3.5 plots the change in manufacturing as a percentage of GDP against the change in mining and utilities as a percentage of GDP over the 2000-2010 period. A process of positive structural change over this ten-year period would be one where there is a shift from mining value added toward manufacturing value added – represented by quadrant one. Only six African countries in our sample fall into this category. In contrast, the figure shows that in most African economies – 35 out of 50 here – mining and utilities have seen a rising share in GDP over the period. The fast growing, resource-rich economies of Zambia, Burkina Faso, Chad, Guinea and Côte d'Ivoire have witnessed some of the largest shifts of economic activity toward these two sectors. Conversely, there are also the fast-growing economies of Angola, Nigeria, Ghana and Mozambique, which have seen large declines in mining and utilities over this period. However, these are economies that are starting

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<sup>4</sup> Industry comprises value added in mining, construction, electricity, water, gas and manufacturing, the last of which is also shown separately in the table.

**TABLE 3.2** Sectoral breakdown of economic activity in Africa, 1990, 2000 and 2010-2012

Region	Sector	1990	2000	2010	2011	2012	1990-2000 change	2000-2012 change
North Africa	Agriculture (% of GDP)	21.46	18.81	14.18	14.33	14.95	-2.65	-3.87
	Industry* (% of GDP)	31.83	34.40	35.59	35.65	35.69	2.58	1.29
	of which: Manufacturing (% of GDP)	15.17	14.28	13.87	13.93	12.89	-0.89	-1.38
	Services (% of GDP)	46.71	46.78	50.24	50.02	49.36	0.07	2.58
West Africa	Agriculture (% of GDP)	34.97	34.47	31.27	29.54	28.83	-0.50	-5.64
	Industry (% of GDP)	21.82	23.41	22.37	24.47	29.18	1.59	5.77
	of which: Manufacturing (% of GDP)	9.56	8.91	6.00	5.87	5.99	-0.65	-2.92
	Services (% of GDP)	43.21	42.12	47.26	47.12	43.08	-1.10	0.96
East Africa	Agriculture (% of GDP)	39.91	32.74	32.63	32.92	35.95	-7.17	3.21
	Industry (% of GDP)	16.60	16.58	18.45	18.65	17.06	-0.02	0.49
	of which: Manufacturing (% of GDP)	8.82	7.81	8.41	8.26	7.84	-1.01	0.03
	Services (% of GDP)	43.49	50.68	48.92	48.43	46.99	7.19	-3.69
Central Africa	Agriculture (% of GDP)	30.83	25.01	32.32	32.13	39.73	-5.83	14.72
	Industry (% of GDP)	27.26	38.49	36.71	37.90	27.59	11.23	-10.90
	of which: Manufacturing (% of GDP)	10.97	7.05	4.06	4.13	4.35	-3.91	-2.71
	Services (% of GDP)	41.91	36.51	30.97	29.97	32.68	-5.40	-3.83
Southern Africa	Agriculture (% of GDP)	18.44	14.68	12.15	11.78	9.15	-3.76	-5.54
	Industry (% of GDP)	34.68	33.21	32.84	32.98	31.73	-1.47	-1.49
	of which: Manufacturing (% of GDP)	17.92	15.39	14.78	14.16	11.44	-2.53	-3.95
	Services (% of GDP)	46.88	52.40	55.01	55.24	59.13	5.52	6.72

**Source:** World Bank (2014b) and own regional average and change calculations.

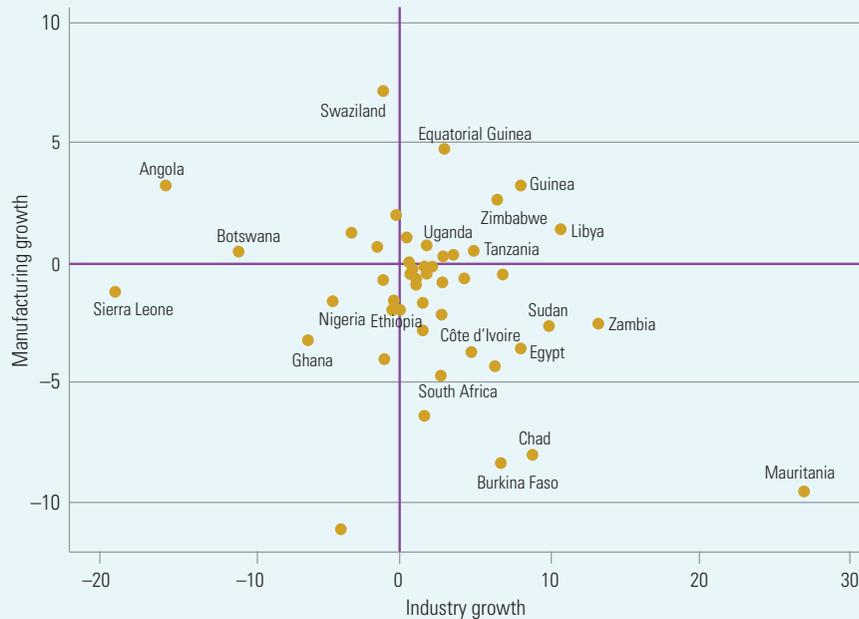
**Note:** \*Industry corresponds to International Standard Industrial Classification (ISIC) divisions 10-45 and includes manufacturing (ISIC divisions 15-37). It comprises value added in mining, manufacturing (also reported as a separate subgroup), construction, electricity, water and gas.

off on an initially very high base, since they yield very large shares of mining in GDP. For example, for Angola and Nigeria, mining and utilities continue to contribute up to 53.0 per cent and 44.0 per cent of GDP, respectively.

Overall, Africa's transition out of the primary sector predominantly into tertiary sector activities has not resulted in preferred economic development outcomes. This is because these activities are largely informal and not particularly productive. Hence, the growth of these largely informal sector activities is concentrated in low productivity areas of economic activity. In attempting to calibrate this shift, McMillan, Rodrik and Verduzco-Gallo (2014) estimated that structural change in Africa from 1990 to 2005 made a sizeable negative contribution to overall economic growth by as much as 1.3 per cent per annum on average.<sup>5</sup> Labour has moved in the wrong direction, toward less productive sectors.

<sup>5</sup>A similar result was found for Latin America. Asia was the only one of the three regions that saw a positive contribution of structural change to economic growth over this period. The authors also acknowledge the substantial heterogeneity across the experiences of different African countries.

**FIGURE 3.5** Change in industry and manufacturing as shares of GDP, 2000-2010 (per cent)



**Source:** World Bank (2014b) and own calculations regarding changes over time.

**Notes:**

1. Industry comprises value added in mining, construction, electricity, water and gas. Manufacturing has been removed from this category and represented separately.
2. For some countries where 2010 data were not available, the latest available year after 2005 was used.

Africa's growth path is therefore characterised by: being heavily dependent on natural resources; having experienced poor performance of the manufacturing sector, which has the ability to absorb excess labour into higher-productivity sectors; and having an over-reliance on subsistence farming. Furthermore, the skewed nature of land ownership and access to agricultural land is likely to have an important impact on incomes in rural areas. Although data on public investment in agriculture are sparse, data for 12 African countries show that only 3.2 per cent of total agricultural land is irrigated and the use of machinery (i.e., tractors) is limited in this sample of economies (World Bank, 2014b). Thus, the benefits of economic growth are accrued to more capital-intensive sectors. This lack of economic diversification, particularly where there is a dependence on natural resources, makes African economies more vulnerable to external shocks. This may lead to a more volatile macroeconomic environment to which the poorest people are most vulnerable.

Positive structural transformation is relevant to the discussion on inequality since a vibrant manufacturing sector will generate a large number of labour-intensive firms, which in turn boost wage employment. This would compress wage distribution and hence decrease income inequality. In contrast, capital-intensive sectors have the potential to generate higher economic growth, but fewer jobs. Therefore, depending on the nature of the growth-inequality relationship in each economy

(impacted by the sources of growth and initial conditions), either of the above growth paths can have a different impact on distribution of income.

### **3.4 Drivers of inequality in Africa: Microeconomic and institutional considerations**

A historical institutional perspective provided by Acemoglu, Johnson and Robinson (2001), Acemoglu and Robinson (2010) and Bratton and Van de Walle (1997) is summarised here. According to this literature, Africa has historically lagged behind in terms of institutional formation. An important factor behind Early Modern Europe's sustained economic growth was the reform of the state that moved away from absolutism (i.e., where the power of the ruler is absolute and unconstrained by institutions) (Acemoglu and Robinson, 2010) and patrimonialism (i.e., where the state is associated with the person of the ruler such that there is no distinction between the wealth or assets of the ruler and that of the state). While this transition was taking place in Western Europe, absolutism and patrimonialism were persisting in Africa and perhaps even intensifying. Thereafter, the 17th and 18th century intensification of the Atlantic slave trade catalysed warfare across the continent and fuelled the import of guns and ammunition that Europeans exchanged for slaves. This conflict and slavery had perverse effects on domestic economic and institutional formation, and distorted the incentives of those in power: institutions became "perverted by the desire to capture and sell slaves" (Acemoglu and Robinson, 2010: 30). The end of the slave trade reduced the external demand for slaves, but gave rise to 'legitimate commerce' – i.e., the export of African commodities to global economic powers – to which those who would have been sold as slaves were put to work in extractive industries. The subsequent impact of the European colonial period during the 19th Century was to reinforce Africa's institutional path, remove the possibility of any endogenous institutional reform, and create the 'dual economy'. There was very little possibility for most Africans to transition from the traditional economy to the modern economy, or to even acquire the means to do so, such as education.

Post-colonial Africa has largely been unable to reform the absolutist structures that were embedded in colonial, political and institutional systems. These ideas rely on a form of path dependence. Furthermore, European colonial powers arbitrarily put together very different ethnic groups of people and created countries that would be difficult to govern and vulnerable to conflict in the post-colonial period.

It is also important to note that ethnic fractionalisation remains a driver of horizontal inequalities since it impacts the way the state implements policies and provides public goods and services (Stewart, 2002). Using data from 18 SSA countries, Jackson (2013) shows that, in ethnically diverse communities, access to water, electricity and education is lower. For education, in particular, he finds that those belonging to the dominant ethnic group have greater access to education. The reasons driving this could be that the language of instruction at schools disadvantages minority children and reduces the value of their education. Another reason could be that minority groups have inferior labour market opportunities, lowering the returns to education for them relative to majority groups. Alwy and Schech (2004) confirm this finding for Kenya, where they show that access to education is higher and the quality of education is better in the home provinces of the ruling elite.

Finally, ethnic diversity has been shown to affect the ability of a community to act collectively. Collective action within ethnic groups has been shown to be more efficient than that between groups,

and in effect, individuals in diverse communities are less willing to contribute to the public good (Vigdor, 2004; Miguel and Gugerty, 2005). This impacts on communities' ability to act together to hold governments accountable, thus perpetuating historical horizontal inequalities. Chapter 10 provides empirical evidence on the link between income inequality and conflicts in Africa. It concludes that conflicts are driven by multidimensional inequalities including economic, social and political inequalities.

In summary, the high levels of initial inequality in SSA are related to how the natural endowments in the region shaped the nature of colonial institutions (Van de Walle, 2009; Bigsten and Shimeles, 2004). These created conditions for the high levels of inequality found today. High levels of post-independence inequality in many African economies, it is argued, resulted largely from the fact that there were small European populations (that still retained wealth), small highly extractive administrations and a focus on law and order rather than economic development. Upon independence, then, wealth was transferred to only a small group of African elite. Furthermore, there were sub-national tensions (ethnicity, religion and/or race) that further determined the initial distribution of resources and may continue to determine the provision of public goods and access to labour market opportunities. Within this context, this section will thus attempt to briefly explore the role of extractive industries in driving inequality in Africa, primarily through its impact on governance. This topic is discussed in more detail in Chapter 6.

### *3.4.1 Natural resources and inequality*

As shown in Chapter 6, when comparing the distributions of population-weighted Gini coefficients for resource-dependent and non-resource-dependent countries, the average levels are similar, but there are a number of resource-dependent countries with very high levels of inequality; (a Gini around 0.60), which overlaps closely with the seven outlier economies highlighted above. This points to a greater risk of high inequality outcomes in countries that are more dependent on natural resources.

It has been widely reported that the commodity boom over the past decade has fuelled impressive growth performances in many African economies. However, this has not always translated into welfare gains for the populations of these economies. Due to rapidly rising income levels within highly unequal societies, the gains to growth have disproportionately accrued to the few richest, resulting in high levels of inequality and the widespread failures to meet many development targets, even by middle-income countries like South Africa. Some of the important ways in which the reliance on extractive industries can drive within-country inequality are outlined below (an in-depth discussion is found in Chapter 6).

There is a growing body of literature suggesting that natural resource dependence impacts inequality and development generally more indirectly through its impact on governing institutions (Bulte, Damania and Deacon, 2005). The state is arguably the most important agent that can catalyse redistribution of income in highly unequal societies by implementing fair fiscal policies (including progressive tax collection and spending on quality public services) and regulating market structures (see Chapter 7 on the relationship among fiscal policies, distributions and income inequality in Africa). The relationship between institutions and resource dependence is a complex one: institutions are influenced by the type of resource endowments and the pattern of dependency, and gains from resource dependence are dependent on the initial strength of institutions. More concretely, resource dependence can impact the democratic process through inducing less transparency in the electoral

process and in the granting of mining licenses, resulting in less effective government and hampering civil society engagement in the governing process.

There are several other channels through which resource dependence and extractive industries may be inequality-inducing: (i) their high capital intensity typically limits lower-skilled employment creation; (ii) lack of Industrialisation (to create broad based employment) can occur either through Dutch disease or where elites who are in control of resources resist this process; (iii) illicit financial flows, illegal tax evasion and trade mispricing deplete resources that could be used for productive and inequality-reducing investments; and (iv) social protection and progressive taxation is used less effectively in highly resource-dependent countries.

### *3.4.2 Governance and institutions*

Despite the governance and institutional challenges that remain in most African countries, the continent has transitioned toward more democratic leadership over the last two decades. According to Freedom House (2014), there were only four full electoral democracies in Africa in 1990, which increased to 20 countries by 2014. While democratisation has come in waves, with countries shifting between democratic and other regimes, democratic principles are becoming entrenched in some societies. Nonetheless, elections in Africa do not always produce representative governments, and with poorly educated electorates, it is difficult to hold government officials accountable.

The previous section focused more explicitly on the link between institutions related to natural resources and the possible impact on inequality. More generally, however, the state has the potential to play a key role in reducing inequality. Fundamentally, the effective management of public funds and investment in key areas such as education and job-creating industries can only positively contribute toward narrowing income distribution. Furthermore, it could also leave fiscal space for targeted social protection policies for the most vulnerable. Regulating market structures, as mentioned in the previous section, is also an important aspect of state regulation, which can help to create more equitable market structures.

These elements of governance go beyond following democratic processes and require the capacity to design and implement effective policies and to regulate efficiently, and the political will to eradicate negative elements such as corruption that serve only to enrich political elites in otherwise low-income countries.<sup>6</sup> These are areas in which African governments perform poorly.

### *3.4.3 Demographic changes and the labour market*

The nature and response of the labour market in growth-poverty-inequality interactions is important. First, in the context of examining the inequality-growth relationship, labour-demand responses during a growth episode in an economy will often shape and influence the private distributional consequences from growth. A typical example of this response, on the basis of cross-country evidence, has been the advent of skills-biased labour demand shifts, where domestic economies have witnessed a disproportionate increase in the demand for skilled relative to unskilled workers during periods of economic growth.

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<sup>6</sup> Even when public investments are made, they are often not equitably spread out within countries. This may drive inequality along spatial lines (for example, urban-rural) and may exacerbate conflicts within countries.

A second example of the relevance of the labour market to these broader debates is within the arena of initial income inequality. It is entirely possible that high levels of initial income inequality are in large part located within the labour market. High levels of initial wage inequality in a society may be precisely the labour market's expression of how initial income inequality impacts growth-poverty elasticities.

Relatively high wage incomes from the formal as opposed to the informal economy, for example, may be the key determinant of initial income inequality in a society.<sup>7</sup> The reason, in turn, that Gini coefficients are so inelastic to economic growth may in part lie with the difficulty in, and long-run returns to, altering an unequal and poor-quality schooling system within an economy. Human capital formation must therefore feature as one of the key issues identifying both the cause and solution for overcoming the low growth-poverty elasticities yielded through high inequality levels. See Chapter 11 on the relationship between inequality and human development in Africa.

This is particularly important when considering the projected demographic changes for Africa, where the growth of the young working-age population is expected to be rapid. Regional population growth rate projections for the 2010-2030 period show that growth of the global workforce will be driven by Asia, Latin America and Africa.<sup>8</sup> More specifically, it was projected that the region that would have the fastest-growing working-age population would be Africa. This translates into a working-age population of 793 million in 2030, a 70.0 per cent rise from the current 466 million.

Understanding the composition of the growth in the working-age population is important given that it is the rapid entry of young workers that is most likely to put pressure on the labour market. Africa's youth working-age (15-24) population is expected to grow at multiples of that of Latin America and Asia for the next decade and a half (Bhorat and Naidoo, 2015). In countries like Nigeria, the youth bulge means that youth (15-24) will make up a third of the labour force at least until 2030 (Lam and Leibbrandt, 2013).

The above suggests that Africa's projected demographic changes have two main implications on its labour force. First, most of the world's working-age population growth will emanate from Africa. From 10.0 per cent of the global labour force in 2010, this is set to increase to 15.0 per cent by 2030 (ILO, 2011). Second, most of this growth will originate from young workers in Africa, who are primed to stream into the labour market at an average annual rate of over 2.0 per cent<sup>9</sup> in the 2010-2030 period. This represents both the opportunity for potential growth and the challenge of promoting growth that is job-creating.

Turning to the current global labour market landscape, Bhorat (2013)<sup>10</sup> shows that of the 3 billion people in the global labour force, only half of them are in wage employment, which is loosely defined as employment in which one earns a wage, either formal (officially recognized contract) or informal (oral/implicit contract). In SSA, however, a large majority (74.0 per cent) of the 297 million employed

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<sup>7</sup> Standard income source decompositions of the Gini coefficient, for example (see Lerman and Yitzhaki, 1985), can enable one to empirically establish the contribution of regular wage or self-employed income to overall inequality – relative to, for example, state transfers of interest income.

<sup>8</sup> United Nations Population Projections (2010).

<sup>9</sup> The total percentage change of young workers in SSA (age 15-24) over the 2010-2030 period is 55.0 per cent.

<sup>10</sup> Using data based on the World Bank's International Income Distribution Database (I2D2) database, which is a harmonised set of household and labour force surveys drawn from a multitude of countries.

individuals are not in formal wage employment but, rather, are self-employed.<sup>11</sup> This indicates that the incomes of most of the employed in SSA are directly dependent on the profits of their enterprise, which are typically more variable than income from wage employment. Also unique to the region is that, on average, 56.0 per cent of the labour force works in agriculture, compared to 25.0 per cent of the labour force in other non-Organisation for Economic Co-operation and Development (OECD) countries and for the global average. Ultimately, then, 77.0 per cent of the self-employed in SSA work in agriculture, compared with the corresponding figure of 55.0 per cent for other non-OECD countries.

A segmented understanding of an African developing-economy labour market necessarily needs to account for informal work, but more particularly, informal agricultural work and associated labour dynamics. Since labour in the region primarily involves activities related to working on land in rural areas (typically low-earning work), employment in the current context (self-employed agricultural work with associated inadequate earnings) will not be sufficient to narrow income distribution and thus reduce income inequality.

The typology of Africa's jobs challenge is evident in the above data. In the first instance, since agriculture is so central to the average African economy, policies designed to promote growth in this sector, increase its global competitiveness and essentially serve as mechanisms for reducing the incidence of poverty among workers and income inequality are critical. Second, large numbers of predominantly young people are entering Africa's fast-growing cities in search of employment; the majority end up in urban self-employment or unemployment. Rendering the informal sector a more sustainable form of employment, creating linkages to the formal sector and providing an enabling business environment for this sector to thrive are essential to a more equitable growth path. Finally, growing Africa's currently minuscule wage employment base must be a key strategy to reduce inequality and grow domestic economies for African governments.

### *3.4.4 Education and human capital development*

The achievement of a primary enrolment rate above 80.0 per cent in Africa, on average, has garnered much praise in the international development community. Beyond this, however, the core problem in overcoming economic development constraint remains the upgrading of the level of human capital in most of Africa. The poor quality of educational systems together with poor post-primary education enrolment rates are central to Africa's human capital challenge and to a more equal future growth and development trajectory.

Data from the Institute for Statistics of the United Nations Educational, Scientific and Cultural Organisation (UNESCO, 2013), clearly show that, although enrolment in primary school in SSA lags behind other developing regions, that of secondary school is of more concern. The data reveal that for the 2012 cohort of learners, median secondary schooling enrolment in SSA was approximately 30.0 percentage points below that found in South Asia and 57.0 percentage points lower than Western Asia. As one moves from primary to secondary schooling, differential enrolment rates increase sharply and dramatically. These significant and large shifts in enrolment rates as one moves from primary to secondary schooling are strongly suggestive of a secondary schooling system within the

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<sup>11</sup> According to ILO (1993), 'wage employment' refers to jobs "where the incumbents hold explicit (written or oral) or implicit employment contracts which give them a basic remuneration..." in the form of wages. 'Self-employment' is defined as "jobs where the remuneration is directly dependent upon the profits (or the potential for profits) derived from the goods and services produced (where own consumption is considered to be part of profits)".

SSA region that is significantly underperforming relative to international comparators. For Africa to move its economy toward higher-productivity sectors – not only to sustain growth, but also to reduce inequality by creating gainful employment for its citizens – it needs an adequate supply of skilled labour.

The regional variation in table 3.3 shows that Central Africa has the lowest secondary school enrolment, with about a 70.0 percentage point difference between primary and secondary enrolment. With the exception of North Africa, which has the best performing enrolment rates in Africa, Southern Africa has the highest secondary enrolment rate, but the level is still less than half of primary school enrolment.

**TABLE 3.3** Enrolment rates in Africa, 2011

% gross	Central Africa	East Africa	North Africa	Southern Africa	West Africa
Pre-primary	22.85	24.92	56.94	69.34	15.72
Primary	108.55	99.31	108.57	120.23	98.84
Secondary	32.99	43.99	69.17	51.27	45.73
Tertiary	6.88	6.92	23.03	10.20	9.78

**Source:** World Bank (2014b), World Development Indicators 2014.

**Notes:**

1. Latest available data.
2. Gross enrolment rates can exceed 100% due to the inclusion of overaged and underaged students because of early or late school entrance and grade repetition.

In addition to enrolment rates, even the quality of education given to children who attend school is poor. The Learning Barometer of the Brookings Institution (2012)<sup>12</sup> reveals that a high proportion of children in school in various African countries are not learning effectively, with proportions as high as 50.0 per cent in Nigeria and between 30.0–40.0 per cent in South Africa, Namibia and Uganda. The effects of children not learning effectively in school can be seen more clearly when African students are compared to those in other developing countries. Using Trends in International Mathematics and Science Study (TIMSS, 2011) data for grade 8 students, the results of standardised mathematics and science tests can be compared. Ranking countries from worst to best reveals that the five African countries included in the data (Ghana, South Africa, Morocco, Botswana and Tunisia) do not compare favourably to comparator countries such as Turkey, Thailand and Chile, and are at the bottom of the distribution.

To combine issues of enrolment and quality of the educational system, Bhorat (2015) calculates Africa’s ‘conversion rate’ – the shares of individuals within a cohort who would have enrolled at primary school and then progressed through the schooling and higher education system.<sup>13</sup> For Africa, the data suggest that there is an equal collapse in the conversion rates from primary to secondary schooling as there is in the conversion from secondary to tertiary enrolment. This is in contrast to the

<sup>12</sup> It covers 28 countries and draws on regional and national assessments to identify minimum learning thresholds for grades 4 and 5 of primary school.

<sup>13</sup> The Technical Vocational Education and Training (TVET) data were not sufficiently reliable to allow for inclusion into this series. It is doubtful, however, that this would change the substance of the results obtained.

performance of the other regions of the world. In essence, for Africa, the data show that for every 100 children of primary school age, only four are expected to enter a tertiary educational institution. In the LAC region, 36 out of every 100 within the cohort should make it to a higher education institution, and even in South and West Asia, this figure is at 14 per 100 individuals. These figures highlight the rapid attrition from the schooling system and serve as a powerful indicator of the ineffectiveness of Africa's educational system.

In the view of long-run economic growth, currently espoused by Thomas Piketty and others, human capital accumulation is one key mechanism through which to overcome a growth path where the rate of return on capital ( $r$ ) exceeds the rate of economic growth ( $g$ ) such that  $r > g$ . To generate a more equal growth path, thus equalising  $r$  and  $g$ , it is argued that the schooling and educational systems plays a potentially crucial role in an economy's long-run growth trajectory. In Africa, on the basis of this supply-side evidence, it is clear that the continent is far from producing a schooling and higher education system that is sufficiently inequality-reducing. See Chapter 11 for more illumination on the relationship between human development and inequality in Africa.

### *3.4.5 Gender dimensions of inequality*

While labour market and educational system challenges contribute to inequality, gender disparities within these institutions are an important source of inequality in Africa. The UNDP's Gender Inequality Index is a composite measure that reflects inequality in achievement between men and women in three dimensions: reproductive health, empowerment and the labour market, where the lower the score, the closer the gender parity. In the global distribution of scores that are available in the data (152 countries), only three African countries score above the median – Libya, Tunisia and Mauritius. African countries are concentrated at the upper end of the distribution, with 28 out of 39 scoring in the worst quartile. The South Asian countries of India, Pakistan and Bangladesh perform better on the Gender Inequality Index than countries such as Malawi, Zambia and Mozambique, which are relatively higher-income countries.

An important driver of gender inequality is access to education, which remains crucially important in determining individuals' labour market outcomes. Since the late 1990s, there has been some progress in equalising access to education for girls and boys in SSA. However, this has predominantly been achieved at the primary education level (The Economist, 2013, using UN Data). Over this same time, there has been no progress on average in achieving gender parity in secondary schooling, and there has been a widening of gender inequality in tertiary educational enrolment. In most other parts of the world, there have been significant improvements in gender parity at higher levels of education.

These differences in educational attainment are important because they predict gender gaps in employment and earnings. According to the International Labour Organisation's 2012 Report on Global Employment Trends for Women, only 14.0 per cent of working women in Africa are in wage employment compared to 29.0 per cent of employed men (ILO, 2012b). Just under 40.0 per cent of working women are contributing family members, compared to 80.0 per cent for men. Income is associated with empowerment and decision-making power within households, where women remain disadvantaged.

A comprehensive analysis of how gender inequality is impeding progress on human development in Africa has been conducted by UNDP (2016). Overall, gender inequality in social services (e.g. health and education services) translates to lower economic opportunities for women, in particular, and

society as a whole. As the economic status of women improves, so does the economic status of entire families. In fact, gender inequality in the labour market alone costs sub-Saharan Africa about \$95 billion annually between 2010 and 2014 (UNDP, 2016).

### 3.5 Conclusions

This chapter aimed to provide a broad overview of the nature and pattern of inequality in Africa. The descriptive statistics highlight that it is difficult to draw simple generalizations about the nature and pattern of inequality across Africa since there is substantial variation in both levels and changes over time. However, a few key observations do emerge. First, Africa's average and median Gini coefficient is higher than the average and the median Gini coefficient, respectively, of the rest of the developing world. Second, a notable feature of inequality on the continent is the presence of seven economies exhibiting extremely high levels of inequality, the 'African outliers', which also drive this inequality differential with the rest of the developing world. Third, over time, based on the available data, average levels of inequality have declined in Africa, driven mostly by the economies not classified as highly unequal. It also emerges that, when estimating the relationship between growth and inequality in Africa, for those countries with initially high levels of inequality, there is a stronger relationship between economic growth and inequality, a confirmation of the cross-country evidence outside of Africa.

In terms of the drivers of inequality in Africa, it is shown above that dependence on natural resources and its deleterious impact on building effective, transparent and accountable institutions remain key determinants of the high levels of inequality on the continent. Second, due to the labour market structure of many African economies, there are large proportions of the labour force involved in low-income, agricultural self-employment or in informal sector jobs, which, when compared to the small share of wage employment in many African economies, often exacerbate inequality. The low stock of human capital is also central to this phenomenon. Individuals with a sufficient level and quality of education are able to earn high wage premiums in the formal labour market. Until a large enough supply of skilled workers is available, inequality-inducing skills premiums will persist in African labour markets.

Clearly, growth alone is not enough to lower inequality and reduce poverty in Africa at a rapid enough pace. Growth originating from capital-intensive sectors has a low likelihood of creating the kinds of formal jobs that are needed to narrow income distribution. There is a need to enhance the industrial base of African economies and to build effective higher education institutions that are able to respond to the demands of a growing economy. This would place African economies on a more inclusive and equalising growth path.

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